# JONATHAN DAVIS
Wealth and Later Life Finance Advisers

Chartered Financial Planner

## Booms & Busts Report

**2023 will be a major economic recession.**

It is caused by monumentally bad (malevolent and deliberate? You decide.) political decisions, particularly in recent years, though largely, cumulative, over the last 30. These things don't just suddenly happen. Remember, Kyoto was 1997.

Next year, expect GDP to fall, house prices to fall, unemployment to rise, the stock market to continue crashing (the FT 250 has already crashed around 35% over the last year), and inflation to fall.

The annual rate of UK inflation (RPI, currently a **huge 14.2%**) ought now to fall to around 7% by late next year. (Previously, I thought it would go down to 5%, however, they are destroying Pound Sterling. So inflation is higher than expected now and is more likely to remain materially higher than expected.)

**Then what?** Read on.

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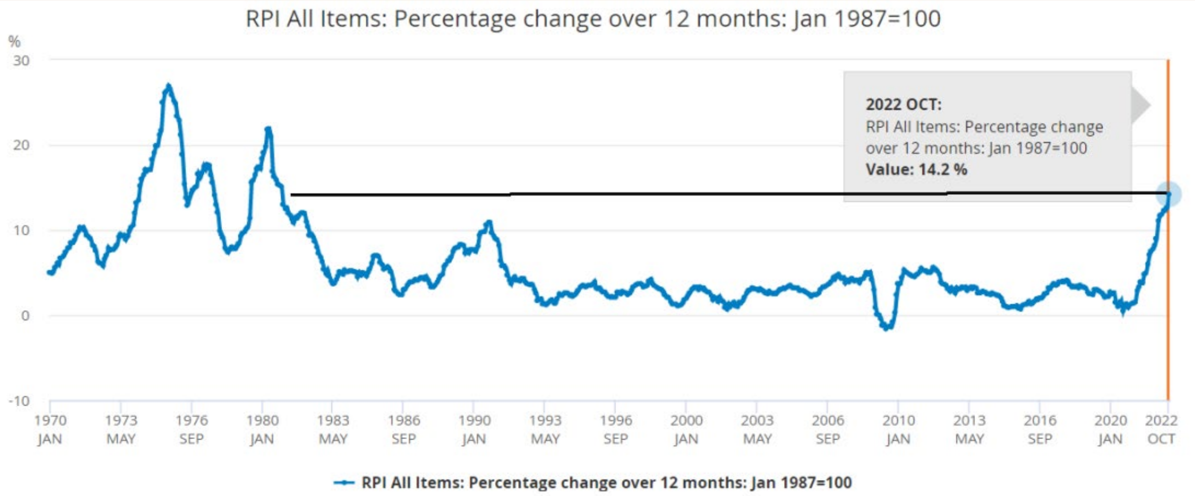
**In this edition of The Booms & Busts Report**

- **Inflation**
- **Recession**
- **Then what?  Assets, incomes, debts.  Are you a Creditor or a Debtor?**
- **FOMO**
- **US$**
- **UK**

**Shocking RPI.**  Did you hear about this in the not-to-be-trusted Not-The-News?




The Retail Price Index is at a HUGE 14.2%, indicating how prices have soared from September 2021 to September 2022.

Again, you know and I know, this is not accurate for everyone.  Moreover, it is grossly underplaying actual inflation for most folk.  (And, on top, they never even discuss the RETAIL PRICES INDEX.  It's always Consumer Prices because, apparently, there's a difference between "Retail" consumers and, er, "Consumers"...!
Realistically, actual inflation has been OVER 20%.  However, I cannot prove it, other than suggesting you look at your Home Energy bills...)

**Notwithstanding, UK inflation -** which is huge because they don't want us to get Energy, efficiently and when we need it (ask yourself why are they doing that), and because they are destroying Pound Sterling (ask yourself why are they doing that) **- is at 40+ YEAR HIGHS!**

Indeed, for four decades, we have experienced sub 5% annual inflation, except for the late 80s.  So, 'everyone' had forgotten that it was possible and what it means.

What it means is everyone is becoming increasingly impoverished.
Do you know anyone who's income has risen over 14%, net of taxes, in the last year?

Do you know anyone who's investments/pensions etc have risen over 14% net, over the last year?

This is why I say 'everyone' is becoming increasingly impoverished.

**And this is just the first year of, likely, 10-20 years of high inflation, with below-inflation earnings increases and below-inflation wealth increases.**

UK residents should expect inflation to be over 6% pa for the next 10 years.  (As I say, it's 14.2% now...!)

At 6% pa, the Purchasing Power of £100 falls by over 30%, over just 5 years.
It falls over 75% over 10 years.

YOU HAD BETTER MAKE SURE YOUR WEALTH WORKS FOR YOU.

Over the last near three years (1 January 2020 to Date), the Typical JD WM Client portfolio has risen over 50%, while official RPI has been ~23%.
How has your portfolio fared Vs the 23% inflation?

More importantly, how will it likely fare over the next 5-10 years Vs inflation?

I suggest you have a long conversation with your financial adviser / portfolio manager.

Read prior Booms & Busts Reports for more, in-depth analyses for why we now have this enormous inflation and what we, at Jonathan Davis Wealth Management, have done to meet the enormous inflation challenge.  Call me to discuss what we have done.  And what we are doing.

**Recession**

Did you ever hear of an economy doing well with high increases in the costs of living and of doing business?  Of course not.

Economies do well with Deflation.  Wouldn't you like cheaper energy?  Cheaper food?  Cheaper goods and services, generally.  So you can eat out more, go on more holidays, buy nice things, *raise your standard of living* etc?
In other words, have a strong economy.

Germany did fantastically well with low inflation, or even falling prices, for decades. Now, with huge inflation, the German economy is dire.  Its manufacturing is being decimated.  Major company after major company is shutting up shop.

The EU economy is, therefore, toast.
The €uro is toast (against the US$). (As bad as the GB£.)
(I am not saying the EU and the Euro will break up and die.  That would require at least one country to leave the EU and the Euro...
I remain (sic!) unconvinced that the UK has left the EU.  Certainly, Northern Ireland hasn't.)

Unfortunately, the politicians, the bureaucrats and the banker-serving central banks e.g. The Bank of England, here, have brainwashed everyone into believing that (low) inflation is a good thing.  It never was.  During relatively low inflation, we only had 1 to 2% economic growth... and that was only due to 5 to 10% pa increases in debt.  Without the debt we would have been in perennial recession.

The debt was, of course, manageable, in a low interest rate environment.

Now that rates have soared, the chickens have certainly now come home to roost, as they always were going to.  Unfortunately, everyone decided not to think about what future high interest rates would be like.
They are forced to consider it now.

The question, above, was "Then what?"

Well, actually, that is as yet unclear.

There are two futures.  Neither is pretty.

1.  House prices fall, unemployment soars, investments collapse... inflation remains high (under 10%) while the politicians continue to stop us getting energy efficiently, and deglobalisation means China is less and less the manufacturing base for the World... perennial recession AKA Depression... until prices fall to a reasonable enough level for the economy to be able to be rebuilt.  (Apart from the abominable (anti the 90%) Net Zero policy) that is the sensible long term approach.

The idea that we can get out of this enormous economic mess without enormous pain is facile and infantile.

2.  Next year (or perhaps H1 2024), with crashing investment portfolios and corporate profits, rising unemployment, falling house prices (I'm estimating down 10%), of course a falling GDP, the politicians will (cough) intervene to, er, help.

Already they're going to subsidise energy to the tune of a most astonishing 7% of GDP.  (Borrowed money.  Instead of allowing oil and gas companies to supply oil and gas! 🤡😠)

In March 2020, with these things happening, especially, crashing government bonds, governments and central banks decided to flood the financial system and the economy with money (printed out of thin air).  By a year later, **inevitably**, inflation and the economy rose, sharply.  Inflation carried on soaring but this, itself, brought subdued growth, then the building recession.  UK GDP has already fallen in three of the last four months and the trend in the size of the economy is now clearly down.

So, next year, or H1 2024, the politicians and the bureaucrats will do as they did in March 2020 onwards.  They will print money out of thin air and shower it on the financial markets and on the economy.  (The UK General Election and the US Presidential Election are in 2024...)

Indeed, just like 2020, they will 'make' the banks lend, lend, lend on incredibly easy terms and at (unprofitably) low rates, with the loans guaranteed by the State.

Thus, like 2020, there will be even higher levels of debt across government and the corporate and household sectors.

The lending will be targeted towards the deglobalisation industries.  Manufacturing will leave / is leaving China and going elsewhere.  Mexico, India, Korea.  Indeed, it will also return to the high cost West.  (Inflationary.)

Manufacturing will have a reboot in the UK and will grow, materially.
Happy Days, you may say!

Sure, unemployment  in this sector will rise, gradually.  This will be a long term boost to the, otherwise, depressed economy, house prices etc.

Inflation, interest rates and the economy will soar, again, until the inflation makes the pips squeak and the economy stalls, again.  That would be by 2026 or 27.  Then we crash and go into recession again.

The big picture objective of Financial Repression is to, over time, bring the debt level down relative to GDP/prices (as they had achieved by 1982, after 30+ years of rising inflation).

Alternative #1 is painful but would sort out our terminal long term economic illness.  Hence, this is unlikely to happen.

Alternative #2 will bring nominal (ie before you take into account inflation) economic growth, probably long term.  At a price of much higher long term inflation.  Earnings will rise, materially, for those in work, but unlikely to fully keep up with the costs of living.

Wealth i.e. investments, pensions etc will almost certainly fall (plummet), relative to the costs of living / purchasing power.  Property is unlikely to keep up with inflation.

Total Debt will fall RELATIVE to the size of the economy.  This is what happened in the Financial Repression of the late 40s to the late 70s, by when Total Debt to GDP was under 100%.  (It's now over 300%.  It was 150% after WW2, and that was deemed far too high.)

Overall, there will be a lot more debt, nominally, but it will be less (relative to inflation-raised GDP) and **there will be much more poverty.  (Think the late 1970s.)**

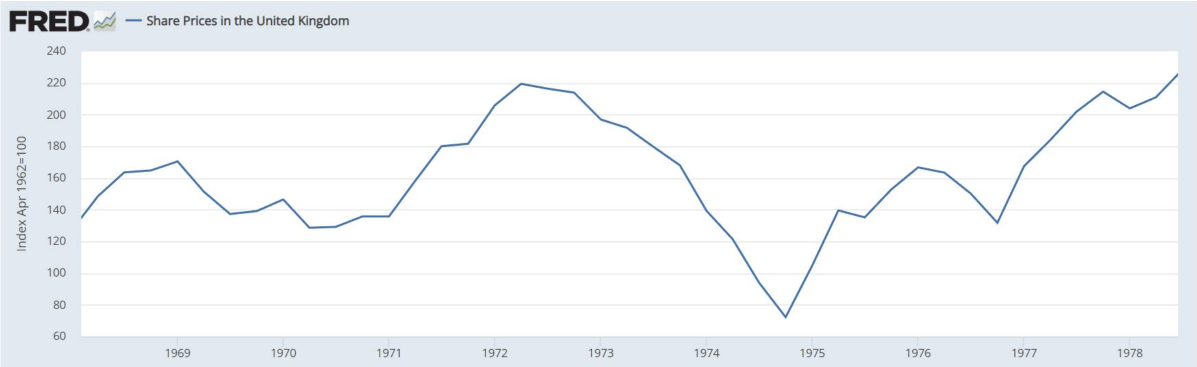
Which of these do you think will happen?

As I say, I imagine #2 will be what happens next.  We will know more by next year (or 24) i.e. as we come out of the major economic recession and markets collapse.

**From your perspective, 90% of folk, I believe, will lose out and wealth will be much lower (decimated probably) relative to the costs of living.** Imagine a loaf of bread at £5, for example.  A standard car at £75k.  An overseas flight at £5,000, not £500.  And so on.

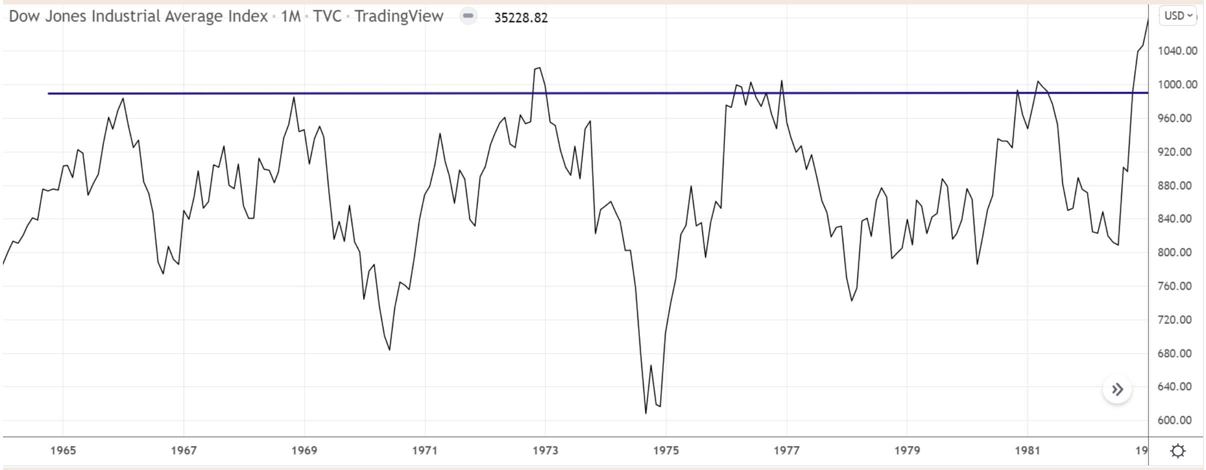
Over the next 10 years, expect little returns on property, shares and bonds... while the costs of living will have gone up leaps and bounds.  So, your wealth will be severely diminished, even if the total value of your wealth stays similar to today. This is exactly what happened between the mid 60s and the late 70s.

**UK Stock Market (late 60s to late 70s)**




It was even more pronounced in the US.

**Dow Jones Index (mid 60s to early 80s)**




As you see, during the many years of rising and high inflation, stocks did very little, or nothing.
(Since 1982, Stocks have done well as interest rates just fell, decade after decade, and corporate profits rose.) **In 2022, most stocks prices, in portfolios, have lost a third of their value.**

On top, Government Bonds were annihilated as interest rates soared from 3% to 15-20% over the 10-15 years. (Since 1982, Government Bonds have done well as interest rates just fell, decade after decade.) In the last 2 and a half years, **Government Bonds have lost half their value**, as interest rates have soared.

Property did reasonably well in that long period of inflation, nominally, as interest rates and earned incomes soared. Though, for the middle 70s, with UK inflation at 25%+, house prices were flat. (In Real terms, prices collapsed.)
**However, property started that era of high inflation, with multi-generational low prices. Now they are at multi-generational high prices...)**

**Wealth was destroyed in this 10-15 year period.**

**<u>I believe we are in a very similar era.</u>**

The primary difference, as I see it, is that interest rates are unlikely to be allowed to run riot and rise to (well into) double digits. This will actually fuel inflation even higher.

You see, 40 years ago, total debt was 100% of GDP and rates went to say 15-20%.

Now, debt is 300-400% of GDP and rates will likely be kept 'down' to 4-5% or so.

Mathematically, that will actually be the same relative cost to aggregate income as was 20% rates to debt of 100% of GDP . And just as painful to the 90% of folk.

**Relative economic strength is moving, gradually or rapidly, depending on your point of view, from:**

**The creditor i.e. those with wealth i.e. property and investments/pensions to:**

**The debtor i.e. those with high debts - assuming they can sustain the high payments with relatively low interest rates - and small assets, and good income.**

As earnings rise, debt will become less of a burden, over years - just like when you took out £40k mortgages and, over time, they became immaterial. The problem was you then took out £200k mortgages. Then your children took at £400k mortgages...

All was honky dory while borrowing rates were manipulated down, down, down over decades. It is remarkable the people didn't know (or didn't want to know) that rates would, eventually and inevitably, soar. I have been writing for years that it was coming.

Only last year, mortgage rates were still at 1-1½%. Now they are 6%. A HUGE increase in debt servicing cost. Severely problematic over the medium term i.e. the next few years, for current borrowers. If, however, the highly indebted has a good job, well paid, and, especially, with a decent increase, year to year, over a number of years, they will reduce their other expenditures and they will service the debt and, indeed, pay it down. Over time, the debt will be much more palatable. It will be painful. But, for most folk, in that position, manageable. Just don't expect the free-spending lifestyle you have experienced for many years.

For a sizeable portion of the population the debt will be unmanageable. They will lose their high-paying jobs. They will lose their homes or sell and trade down, move back with Mum and Dad, sell the Buy-To-Lets as the business will just not be as profitable as before. 2nd and 3rd home-owners will sell one or two to reduce exposure etc.

Supply will likely exceed Demand.

By 10 years from now, expect house prices to be far lower RELATIVE to average incomes (for those in work...), even if prices actually remain up, in nominal terms.
House prices can and likely will rise in price, over 10 years. But earnings and costs of living will rise faster. Store or grower of wealth?

As a SOLLA* Accredited adviser (only some 500 of us in the UK, out of 25,000 financial advisers), you should NOT rely on your home to pay for Care Fees, 10 years from now.

* Society of Later Life Advisers - accreditation goes only to highly qualified and expert financial advisers, who can advise on later life finance issues, in particular, paying for Care Fees.

If you are 'long' assets and wealth and 'short' of debt and income, what will you do to "MAKE SURE YOUR WEALTH WORKS FOR YOU"?

You believe your 60/40 portfolios and your property/ies will see you ok?

Think again. THEY will be the destroyer of your relative wealth (relative to the costs of living and relative to others).

**FOMO** (Fear of Missing Out)
With investment portfolios / pensions etc down 10-20% in the UK year to date (down more in the US) **(not our clients...)** financial advisers / portfolio managers et al are in overdrive working hard to assuage client concerns (aka persuade them not to leave for a different wealth adviser / portfolio manager):

- It's a long term investment.
- You gotta be in it to win it.
- From good times, come less good times. The good times will return.
- For goodness sake, do not sell!
- What's the alternative?

These are some of the stock statements used by the account managers aka salespeople. You might have heard them yourself in recent weeks and months. Likely, you will hear these statements next year.

The "Do not sell" advice is particularly problematic for me.
I am comfortable to tell Booms & Busts readers that our typical portfolio is currently 30-35% in Cash, until long term investment opportunities return or new ones open up. That is, of course, one way we have, therefore, reduced investment risk.

Indeed, I have informed clients I would be perfectly comfortable going to 60 or 70% Cash, if the need arises.

What are your IFAs / FAs / portfolio managers doing? Staying in the 60/40 portfolios? Yes, they are not changing much or anything. They may go to 10% Cash. Useful?

Currently, our view is that stock markets have a further 25-50% down to come, over the next 3 - 12 months (perhaps continuing into H1 2024).

If you have 70% in shares and Corporate Bonds, then that's 17-35% further down still to experience, our analysis leads us to conclude. (No comment about the ~30% Government Bonds at this point.)

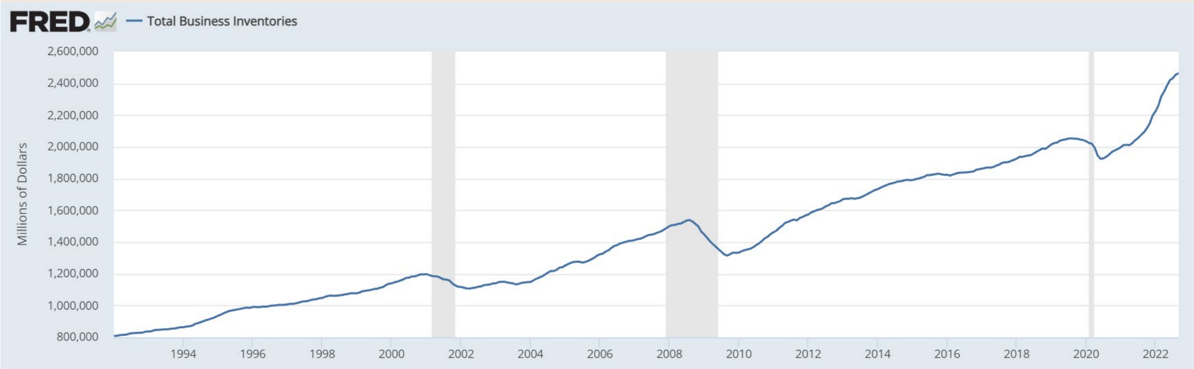
There is no reason why you should just grin and bear it.

On 10 November 2022, the NASDAQ index rose an enormous 7%.  That day now joins the pantheon of the top 20 one-day risers of all time.  Many said the bear market is over and the bull has restarted.  I suspect they are suffering from a markets disease, colloquially, called **FOMO**.

They are constantly in fear of missing out on investing opportunities.  They HOPE (pray, more like) that we've seen the bottom and **Happy Days Are Here Again***...

They aren't.

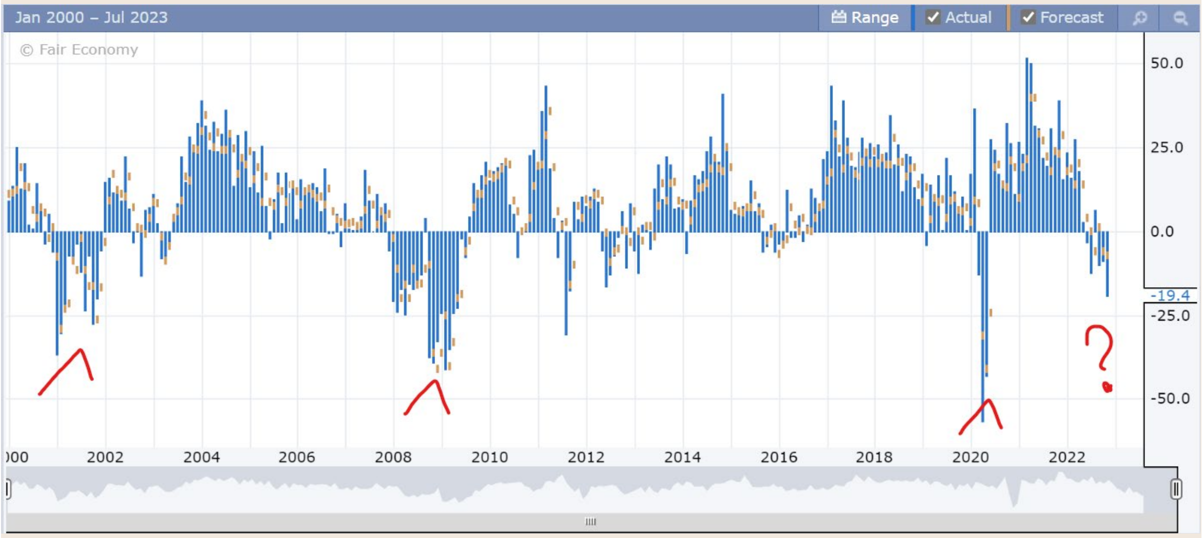
**US inventories**




Inventories (stocks of unsold goods) have soared in the last two years.

Each time, previously, they peaked and fell we had an economic recession, since the 90s.  This will be no different.

**US Manufacturing Index** (Philadelphia FED)




This was just announced.

The markets expected US manufacturing to be down 6%.  It actually fell 19%!

**Nineteen Percent.**

There were economic recessions in 2001/2 and 2008.  And a slow down in 2011.

We are just about to enter a major economic recession.

Corporate profits are just about to fall over a cliff.

etc

Stocks have a LOT further to fall, over coming months.

* **The song came out when?** Originally, November 1929, just weeks after the peak in stocks that, eventually, saw indices fall 90%!   Such hubris.

And it was used in a movie in 1930.  Happy Days were certainly not Here Again in 1930.

As stock markets fall, as they surely will continue to do so, investors wonder where to put the sale proceeds.  As it is liquidation in a recession, they won't be buying Range Rovers, watches, paintings etc.

For the short term they won't buy anything.  They'll hold in Cash, under the bed or in the bank or in Cash Equivalent by, in the UK, buying National Savings products (lending to the government).  There are similar in other countries.

Some, globally, will buy Gold, as the World 'collapses'.

Most will just hold in Cash or Equivalent.

In the US, investors will do this... normally after they've lost a lot of money in the financial markets.

Non-US investors will do this. However, the latter will not hold their money in their currency. Many smart investors - hedge funds, Sovereign Wealth funds, smart private investors and family offices - will hold their Cash in US Dollars.

We have seen the US$ soar over the last year and a half, relative to other currencies... while share prices peaked then plunged, through 2022.

I expect this to continue in 2023.

A rising US$ is normally a negative for commodities eg Oil, Gold, Copper. It often also ties in with a decelerating economy.

Chicken or Egg?

**UK**

A leading indicator, namely Industrial Production, suggests a major recession (fall in GDP) in 2023.

It is forecast, on average, that Real household disposable income* per person will fall by 4.3% in 2022-23. (* Income Increase Vs Inflation. And that's for earners, not for those relying on pensions and investments for income.)

**There have been many years when inflation has been higher than earnings increases. (Higher debts and lower borrowing rates have kept the household budget plates spinning.) That 4.3%, however, would be the steepest drop, by quite some margin, since the modern records began in 1956-57.**

The press and media are now bleating.


DAILY Mirror
Newspaper of the Year
Friday, November 18, 2022 £1.10 (88p to subscribers)

Kate's comfort for kids of war
SEE PAGE 13
WARMTH Princess with five-year-old Zlata yesterday

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AT LEAST THEY LOOK HAPPY

# CARNAGE

» Millions to feel deep pain after Tory hell Budget
» Drop in living standards is the worst since 1956
» 6m into higher tax bands as we go into recession
» Energy bills & joblessness rise, house prices fall
» Hunt & Sunak hail moves.. and shirk any blame
» Truss & Kwasi absent.. as Boris payday revealed

LAUGH Mr Sunak and Mr Hunt in the Commons yesterday

BY JOHN STEVENS Political Editor

**RISHI Sunak and Jeremy Hunt grin yesterday as they plunge millions into economic hell.**

A savage Tory Budget of tax rises and spending cuts will spark the biggest drop in living standards since 1956, experts warned. But as we pay the price of Liz Truss's mini-Budget blunders, Chancellor Mr Hunt shirked any blame for the financial chaos.

Shadow Chancellor Rachel Reeves said: "All the country got today was an invoice for the economic carnage that this Government has created."

FULL STORY: PAGES 4,5,6,7&9

And the TV and Radio are complaining similarly.

None of them blame themselves of course.

They didn't egg on Net Zero for 25 years, did they?
They didn't beg for bailouts in 2008, did they?
They didn't encourage the State to spend, spend, spend, for decades, did they? They didn't encourage debt, by the barrelful, for decades, did they?
They didn't SCREAM for the Lock Ups and then massive money printing, did they?

Course not.

And anyone who suggested reduced spending and fewer State interventions and regulations was hounded out of polite society aka cancelled and their careers ended. Look at Liz Truss, for example.

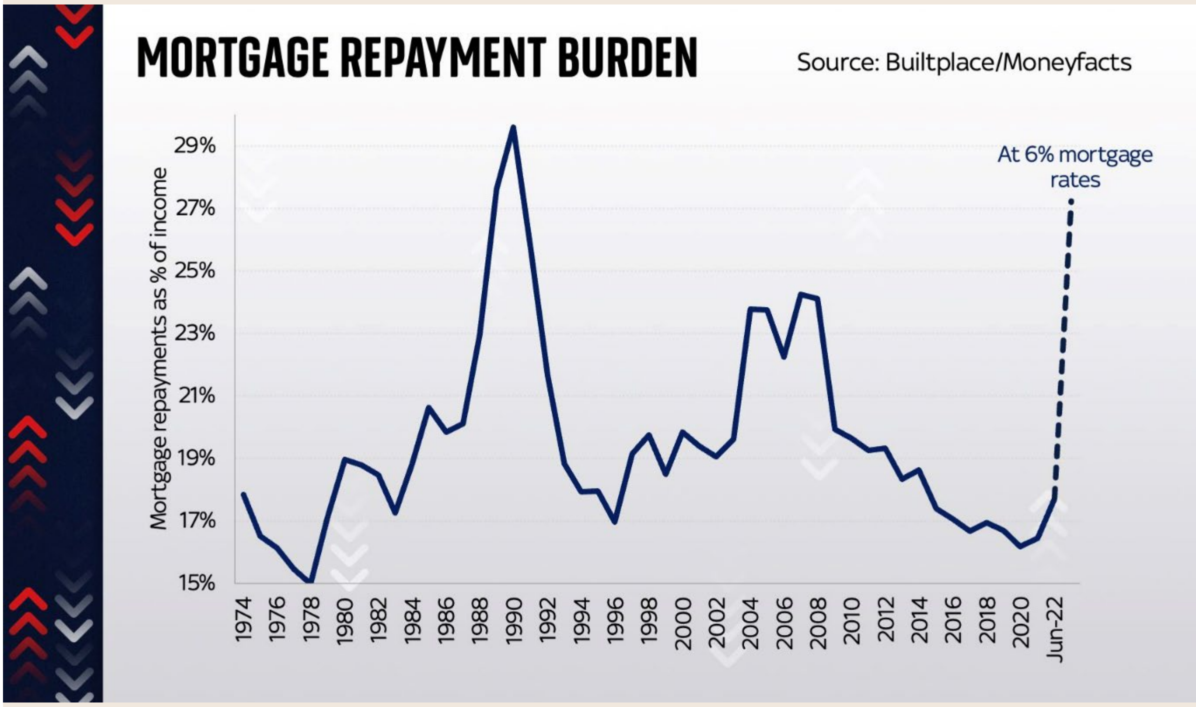
Fortunately, a small number of us survived to remind everyone about this.

**Mortgage Rates and House Prices**


The Office of Budget (Ir)Responsibility has said this:

"House prices are forecast to fall by 9.0% between the fourth quarter of 2022 and the third quarter of 2024"

The forecast for mortgage rates is materially higher, for the next five years (blue), than previously forecast (yellow), only in March. And, since March, they have reduced their forecast for house prices.




The chart shows that mortgages rising to 6% (this is the average now for 2 and 5 year fixed rate mortgages), will raise the payment, as a percentage of net incomes, to 27%. As bad as 1989. Many will recall the ensuing housing bust of the first half of the 1990s.

I recall trading up from a 2 bed flat to a 4 bed detached in March 1994. The time to max out on mortgage and trade up is AFTER a crash, not after a boom.

As you see, the mortgage repayment burden fell from 20% down to 16%, for the last near decade and a half.

All good things...

I think of all the folk who bought or traded up in the last few years, and maxed out their mortgage. They borrowed at, say 1.5%. When their fixes end they will refix at a rate three times higher...

Unsurprisingly, UK housing market demand, in October, fell at the fastest pace since the start of the 2020 Lock Ups and registered one of the largest drops in more than 20 years.

The Royal Institution of Chartered Surveyors' New Buyer Enquiries Index fell for a sixth successive month in the sales market, from -36% in September to -55% in October.

That is the lowest reading since the 2008 financial collapse, excluding Spring 2020 itself, when the housing market was largely shut.
It also marked the fifth-largest drop in the index - which tracks the share of surveyors reporting an increase in demand minus the share reporting a contraction - since records began in 1999, with buyer demand negative across all parts of the country.

**Society of Later Life Advisers - SOLLA**
As I mentioned above, I am accredited by this body. Only around 1 in 50 financial advisers are so accredited.

The thing to note is that the apparent change to Cap Care costs, which was coming next year... is no longer coming.

You can find it in the long grass.

Anyone with whom I had a conversation about Care Fees, in the last year, will know I said I'll be surprised if the new regime comes in. I was right to be sceptical.

There is no cap in Care Fees. If you have to pay them (if you own a home you have to pay them) then expect to pay £40k to £100k pa, depending on what part of the country you're in and what services your Home provides (assuming you move out of your home). (Some Homes can cost £150k pa+. Exclusive, of course.)

As a SOLLA adviser I can help you and advise the most efficient way to pay for these enormous fees. Also, I advise on the many related issues pertaining to Later Life Finances.

**My Service**

I advise clients on Wealth Advice and Later Life Advice all over GB and, indeed, on four continents.

**"We advise you based on what we would do, were we in your shoes, given what we know."**

Call me personally to see how we can help you.

I think most folk do not realise the sizeable risks and opportunities in investment markets.
They will. But will they have benefitted from correct actions taken?

Follow me on Twitter @j0nathandavis where I frequently comment on markets and economics and where you will see day-to-day thinking, and sometimes big picture.

Thank you for reading. I hope you found it interest and, perhaps, useful.
If you have any queries over any of the issues raised call me or email by clicking ***here*.**

With kind regards

**Jonathan Davis** **BA MBA FCII FPFS EFP**
**Wealth and Later Life Finance Adviser**
**Chartered, Financial Adviser and Economist**

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ACCREDITED

Chartered Financial Planner

# JONATHAN DAVIS

Wealth and Later Life Finance Advisers

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0345 862 2919
jonathandaviswm.com
Hawthorn House, Hoadleys Lane, Crowborough TN6 1TH